

**CITY OF ASHEVILLE**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**June 30, 2006**

As management of the City of Asheville (The City), we offer readers of the City of Asheville's financial statements this narrative overview and analysis of the financial activities of the City of Asheville for the fiscal year ended 2006. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in the City's Notes to the Financial Statements, which follow this narrative.

**FINANCIAL HIGHLIGHTS**

- The assets of the City of Asheville exceeded its liabilities at the close of the most recent fiscal year by \$335,143,674 (*net assets*). Of this amount, \$56,949,678 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$26,318,635.
- As of the close of the current fiscal year, the City of Asheville's governmental funds reported combined ending fund balances of \$48,324,165 an increase of \$10,982,485 in comparison with the prior year. Approximately 35% or \$17,297,352 is the undesignated portion of the general fund, therefore available to spend and has not already been designated for other projects.
- At the end of the current fiscal year, reserved fund balance for governmental funds was \$21,626,787, while unreserved totaled \$26,697,378 or 32% of total governmental fund expenditures.
- The City's total long-term liabilities increased by almost \$5.4 million during the current fiscal year. This net increase occurred in the governmental funds due to an installment purchase agreement the city entered into during the year.
- The City holds the following bond ratings:

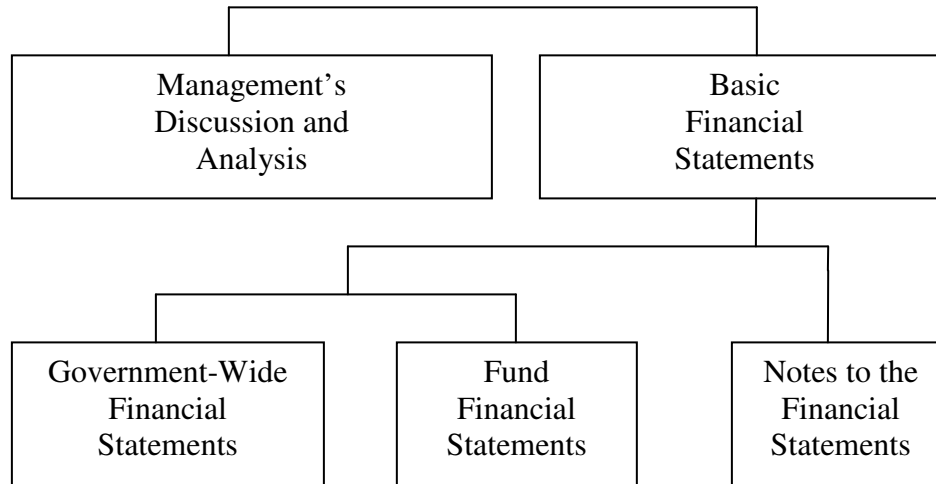
Moody's	Aa2
Standard & Poor's	AA

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the City of Asheville's basic financial statements. The financial statements include two kinds of statements that present different views of the City: 1) Government-Wide Financial Statements and 2) Fund Financial Statements. Both perspectives, however, are essential and complementary components that allow the user to address relevant questions, broaden a basis for comparison, and enhance the City's accountability. Another element of the basic financial statements is the notes to the financial statements. In addition to the basic financial statements, the report contains other supplemental information that will enhance the reader's understanding of the financial condition of the City of Asheville as well as compliance issues that are addressed by Government Auditing Standards, Office of Management and Budget (OMB) Circular A-133 and the North Carolina Single Audit Implementation Act.

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**Required Components of Annual Financial Report**



Summary —————> Detail

**Basic Financial Statements**

The first two statements (Exhibits A and B) in the basic financial statements are the **Government-wide Financial Statements**. They provide a broad overview of the City's financial position and operations, in a manner similar to a private-sector business. The *statement of net assets* presents the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving. The *statement of activities* presents information on how the city's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of related cash flows. Therefore, revenues and expenses are reported in this statement, which result in cash flows in future fiscal periods, such as uncollected taxes and earned but unused vacation leave.

Government-wide statements are divided into governmental and business-type activities. The governmental activities include most of the City's basic services such as public safety, recreation, transportation, community and economic development, and general government. Property taxes, intergovernmental revenues, and other local taxes finance about 71% of the costs of these activities. Business-type activities include water utility, stormwater management, parking, festivals, golf course, civic center, and mass transit services. These activities are primarily paid from charges to customers excluding transit which receives federal grants and transfers from general fund as its primary source of funding.

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The **Fund Financial Statements** (Exhibits C through J) provide a more detailed look at the City's most significant activities. A fund is used to maintain control over resources that have been segregated for specific activities or objectives. Fund accounting ensures and reflects compliance, or non-compliance, with related legal requirements, such as General Statutes, grantor provisions, or the City's budget ordinance. The funds of the City are divided into three categories: 1) the governmental fund statements, 2) the proprietary fund statements, and 3) the fiduciary fund statement.

**Governmental Funds.** Governmental funds are used to account for most basic services and are reported as governmental activities in the government-wide financial statements. Governmental funds are reported using an accounting method called modified accrual accounting, which provides a short-term spending focus. The relationship between government activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds is described in a reconciliation that is a part of the fund financial statements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the entity-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet (Exhibit C) and the governmental fund statement of revenues, expenditures, and changes in fund balances (Exhibit D) provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*. (Exhibit C & E)

The City of Asheville maintains ten individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund. Data from the other nine governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these non-major governmental funds is provided in the form of *combining statements* elsewhere in this report.

The City of Asheville adopts an annual appropriated budget for its General Fund as required by General Statute. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget. (Exhibit F)

**Proprietary Funds.** The City of Asheville maintains one type of proprietary fund. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the entity-wide financial statements. The City of Asheville uses enterprise funds to account for its Water Resources, Civic Center, Festivals, Parking Services, Golf Course, Stormwater Management, and Mass Transit Operations. The City has no internal service funds.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for the Water Resources Fund, which is considered to be a major fund of the City of Asheville. The basic proprietary fund financial statements can be found on Exhibit G through I of this report.

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**Fiduciary Funds:** Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the City of Asheville's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The City of Asheville maintains one agency fund, which is its only fiduciary fund. The basic fiduciary fund financial statement can be found on Exhibit J of this report.

**Notes to the Basic Financial Statements:** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements are on pages 28-58 of this report.

**Other Information:** In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the City of Asheville's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found on pages 59-60 of this report. The combining statements referred to earlier in connection with non-major governmental funds are presented immediately following the required supplementary information on pensions. The other supplemental information shows details about the City's individual funds, including budgetary information required by the North Carolina General Statutes, as well as other data that the City considers helpful to the reader.

## **GOVERNMENT-WIDE FINANCIAL ANALYSIS**

The Government-wide financial statements are designed to provide the reader with a broad overview of the City's finances, similar in format to a financial statement of a private-sector business. The government-wide statements provide short and long-term information about the City's financial status as a whole. The two government-wide statements report the City's net assets and how they have changed. Net assets are the difference between the City's total assets and total liabilities. Measuring net assets is one way to gauge the City's financial condition.

As noted earlier, net assets may serve over time as a useful indicator of a government's financial condition. In the case of the City of Asheville, assets exceeded liabilities by \$335,143,674 as of June 30, 2006.

By far the largest portion of the City's net assets (\$266,117,366 or 79.4%) reflects the City's investment in capital assets (e.g., land, buildings, infrastructure, machinery, and equipment), less any related debt that is still outstanding that was issued to acquire those assets. The City of Asheville uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City of Asheville's investment in its capital assets is reported net of the outstanding related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets are committed to the continued provision of service and cannot be used to liquidate these liabilities.

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**Net Assets of the City of Asheville**

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Current and						
Other Assets	\$ 46,834,443	\$ 59,590,491	\$ 31,649,565	\$ 37,121,233	\$ 78,484,008	\$ 96,711,724
Capital Assets	192,590,745	196,889,755	134,506,297	143,701,439	327,097,042	340,591,194
Total Assets	239,425,188	256,480,246	166,155,862	180,822,672	405,581,050	437,302,918
Non-current Liabilities	31,306,131	36,585,374	54,450,879	49,681,550	85,757,010	86,266,924
Other Liabilities	5,054,344	7,101,440	5,944,657	8,790,880	10,999,001	15,892,320
Total Liabilities	36,360,475	43,686,814	60,395,536	58,472,430	96,756,011	102,159,244
Net Assets:						
Invested in Capital						
Assets, Net of						
Related Debt	168,990,305	173,598,743	80,280,065	92,518,623	249,270,370	266,117,366
Restricted	5,773,547	12,076,630	-	-	5,773,547	12,076,630
Unrestricted	28,300,861	27,118,059	25,480,261	29,831,619	53,781,122	56,949,678
Total Net Assets	\$ 203,064,713	\$ 212,793,432	\$ 105,760,326	\$ 122,350,242	\$ 308,825,039	\$ 335,143,674

As indicated above, assets of the City exceeded liabilities by \$335,143,674 at June 30, 2006. Analysis of the business-type activities indicates that the capital assets increased \$9.2 million in fiscal year 2006. The increase is a result of the termination of the water agreement, discussed in *Note II D*; the City acquired the assets of the golf course from the County and is reporting these activities in a non-major enterprise fund. In addition, stormwater assets that were reported by the City in governmental assets in prior years are now being shown in the business-type activities since the city established a separate enterprise fund to comply with federally mandated water quality protection standards.

A large portion of the City's net assets (79.4%) at June 30, 2006, are investments in capital assets, which are used to provide services to citizens. Investment in capital assets is reported net of the outstanding related debt; however, resources to repay that debt must be provided in future years from current revenues. Restricted net assets, 3.6% of the City's net assets, represent resources that are subject to external restrictions. These restrictions consist of employee paid health benefits as well as reservations for capital projects. In addition, total unrestricted net assets amounted to 17% of total net assets. Unrestricted net assets may be used to meet the government's ongoing obligation to citizens and creditors.

**Governmental activities.** Net assets of governmental activities increased by \$9,728,719. Key elements of this increase are as follows:

- Property tax revenues increased by \$1.8 million or 5.2% during the year. This is attributable to normal growth within the city due to increased housing construction.
- Strong economic growth for the year led to an increase in sales tax revenue by \$1.6 million.

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- The City also acquired the assets of the Nature Center and McCormick Field baseball stadium with the dissolution of the water agreement with the County. This caused the City's capital assets as well as overall net assets to increase. These amounts are reported as special items as discussed in the notes. In addition, new revenues from these activities contributed approximately \$500,000 for the year.
- \$1.2 million was received during the year for the sale of airport property that contributed to the overall financial condition of the City for the year.

**Changes in Net Assets of the City of Asheville**

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Revenues:						
Program revenues:						
Charges for services	\$ 11,602,482	\$ 15,163,538	\$ 28,864,108	\$ 32,882,022	\$ 40,466,590	\$ 48,045,560
Op. grants & contributions	9,553,135	6,645,765	2,501,146	2,171,052	12,054,281	8,816,817
Cap. grants & contributions	346,387	2,897,150	2,164,652	4,137,452	2,511,039	7,034,602
General revenues:						-
Property taxes	35,078,520	36,913,609	-	-	35,078,520	36,913,609
Other taxes	22,802,059	22,192,656	-	-	22,802,059	22,192,656
Grants & contributions not						-
restr'd to spec programs	222,192	1,059,358	-	-	222,192	1,059,358
Inv earnings & misc	2,504,354	2,724,292	34,549	541,966	2,538,903	3,266,258
Gain on capital assets	-	125,982	-	16,852	-	142,834
Special items	-	7,189,066	-	7,004,300	-	14,193,366
Total Revenues	\$ 82,109,129	\$ 94,911,416	\$ 33,564,455	\$ 46,753,644	\$ 115,673,584	\$ 141,665,060
Expenses:						
General government	14,782,234	16,032,815	-	-	14,782,234	16,032,815
Public Safety	31,479,913	33,384,277	-	-	31,479,913	33,384,277
Highway/streets	22,398,691	20,076,196	-	-	22,398,691	20,076,196
Econ Development	5,181,004	4,784,757	-	-	5,181,004	4,784,757
Culture and recreation	7,347,525	7,782,635	-	-	7,347,525	7,782,635
Int on long-term debt	1,181,798	1,179,077	-	-	1,181,798	1,179,077
Water Resources	-	-	21,093,595	20,194,049	21,093,595	20,194,049
Civic Center	-	-	2,360,809	2,251,998	2,360,809	2,251,998
Festivals	-	-	1,067,019	1,269,793	1,067,019	1,269,793
Parking Services	-	-	1,363,805	1,249,256	1,363,805	1,249,256
Mass Transit	-	-	3,927,985	4,262,696	3,927,985	4,262,696
Stormwater	-	-	-	1,994,752	-	1,994,752
Golf Course	-	-	-	884,124	-	884,124
Total Expenses	\$ 82,371,165	\$ 83,239,757	\$ 29,813,213	\$ 32,106,668	\$ 112,184,378	\$ 115,346,425
Increase(decrease) in						
net assets before transfers	(262,036)	11,671,659	3,751,242	14,646,976	3,489,206	26,318,635
Transfers:	(1,941,282)	(1,942,940)	1,941,282	1,942,940	-	-
Increase(decrease) in net assets	(2,203,318)	9,728,719	5,692,524	16,589,916	3,489,206	26,318,635
Net assets, beginning						
of year	205,268,031	203,064,713	100,067,802	105,760,326	305,335,833	308,825,039
Net assets, end of year	\$ 203,064,713	\$ 212,793,432	\$ 105,760,326	\$ 122,350,242	\$ 308,825,039	\$ 335,143,674

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For the most part, increases in expenses closely parallel inflation and growth in the demand for services. The public safety budget increased by 6% for the fiscal year due to funding five new officers to enhance drug enforcement efforts and to follow Council's vision by continuing community-based policing efforts in the community.

Culture and recreation increased \$435,110 during the year due to the additional expenses brought on with the dissolution of the water agreement as previously mentioned. This included expenses to run the new facilities, add a new fundraising specialist and to also fund increased operating hours for summer day camp programs in the community.

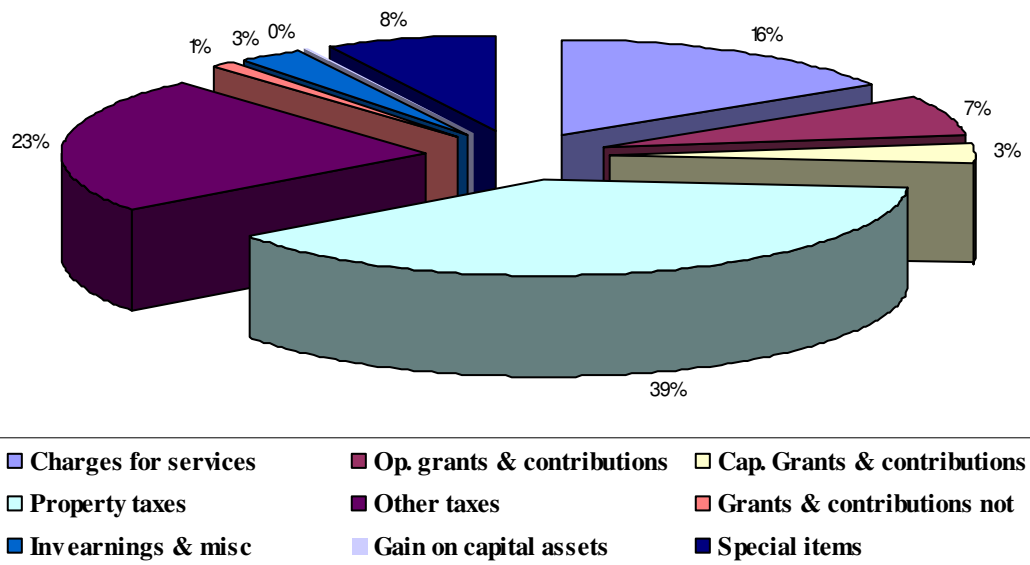
Highways/streets decreased as compared to last year due to repairing the damages caused by Hurricanes Frances and Ivan's devastating blow to the City in FY 2005. In addition, several employees and other operating expenses classified in this division in prior years were transferred to the new stormwater fund.

Other general government activities regarding housing initiatives include:

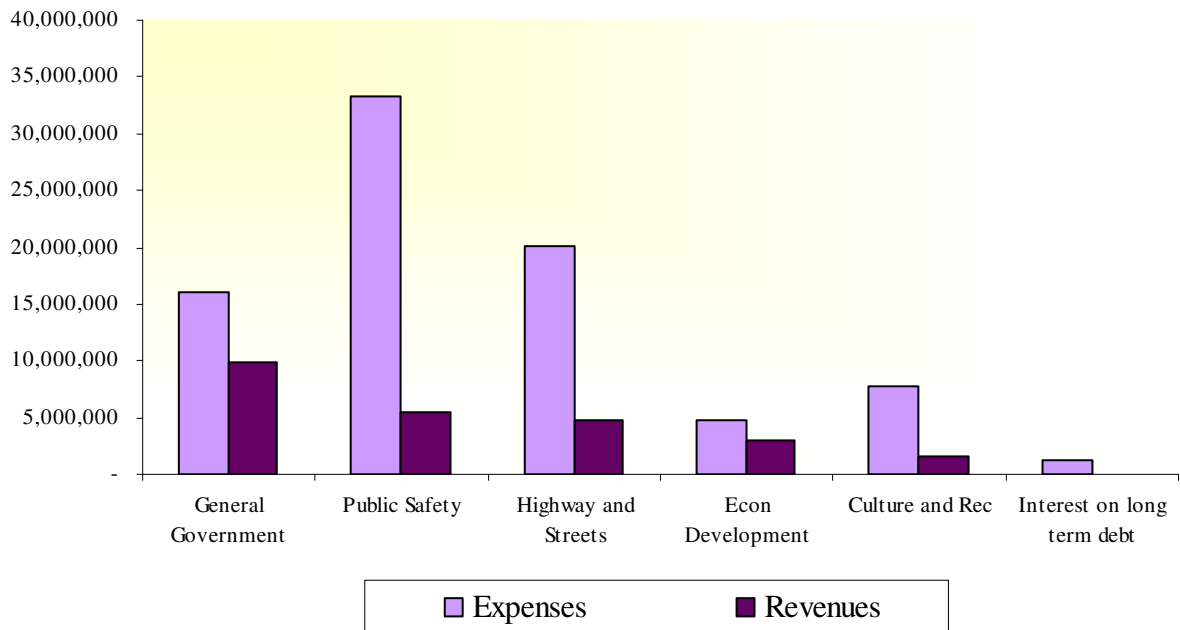
- Katrina Assistance: The city operated an interim housing assistance program between November 2006 and March 2007, using a total of \$49,050 in FEMA funds to assist 23 families displaced by Hurricanes Katrina and Rita with housing advice, rent assistance, and other housing-related expenses.
- Housing Trust Fund: Fifteen new homes, assisted with Housing Trust Fund loans, were completed in FY 2006. Nine were sold to families with income below the area median and six were rented.
- CDBG and HOME funds assisted the production of 204 affordable housing units by the City and non-profit partners. CDBG funds were also used to assist over 3000 people with needed services, including 116 homeless people who moved out of homelessness into permanent housing, to start or expand 61 small businesses, and to upgrade 1560 linear feet of substandard waterlines.

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**Revenues by Source - Governmental Activities**



**Expenses and Program Revenue - Governmental Activities**



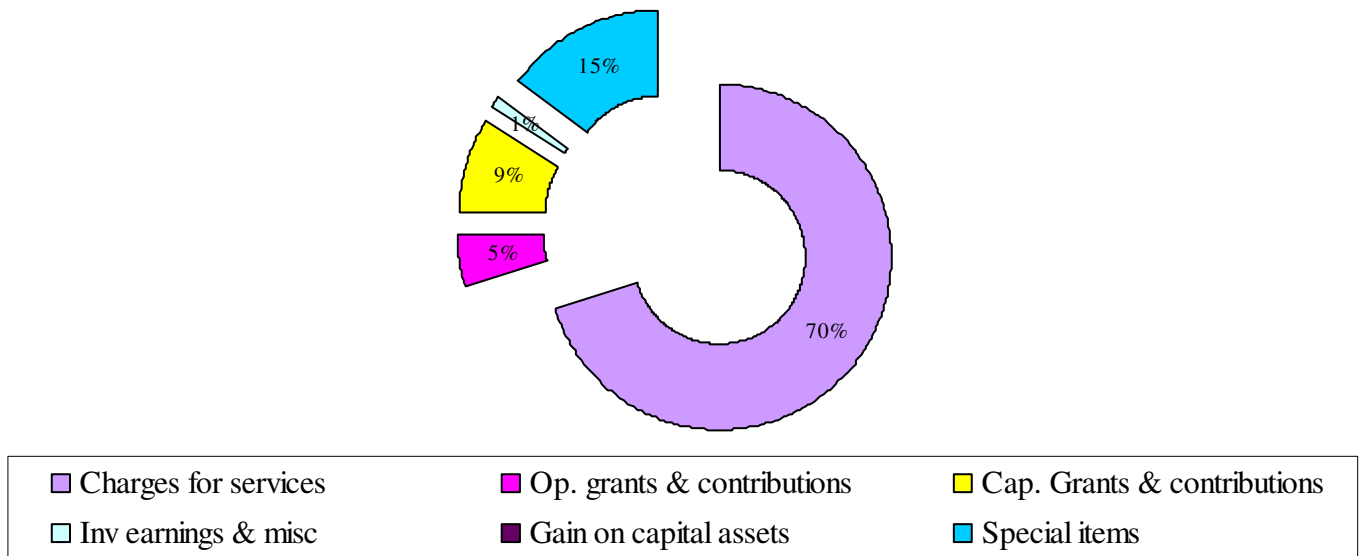


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**Business-type activities.** Business-type activities increased the City of Asheville's net assets by approximately \$16.5 million for FY 2006. Key elements of this increase are as follows:

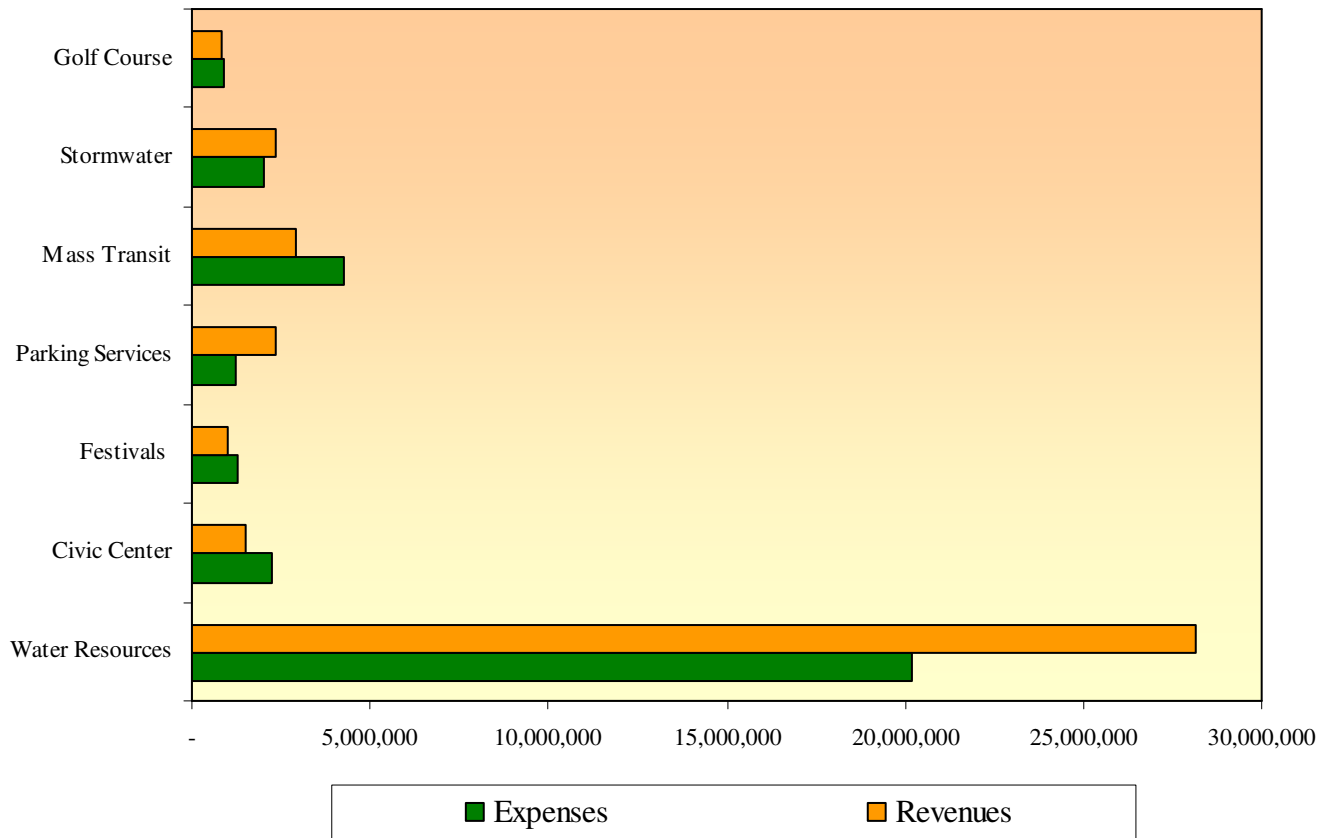
- Overall operating expenses for enterprise funds increased by \$2,293,455 or 7.7% for the year. The new expenditures in the stormwater utility fund accounted for 87% of the increase which totaled \$2.0 million total expenses. \$5.0 million worth of capital assets were transferred to the stormwater fund from the government's general fixed assets for the year.
- Water resources, parking and civic center showed a combined decrease of \$1,122,906. The largest increase occurred in the water fund. Operating costs decreased approximately 4% due in part to the elimination of the in lieu of tax payment to Buncombe County tied to the water agreement.
- Transit expenses increased approximately 8.3% due to increased fuel costs; however, \$414,268 additional grant revenue dollars countered the increased cost of operations.

**Revenues by Source - Business Type Activities**



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**Expenses and Program Revenues - Business Type Activities**



**Capital Asset and Debt Administration**

**Capital assets.** The City's investment in capital assets for the governmental and business-type activities as of June 30, 2006, totals \$340,591,194 (net of accumulated depreciation). These assets include land, buildings, improvements other than buildings (infrastructure assets, such as streets, sidewalks, and water lines), machinery and equipment, and construction in progress. Summary of major capital projects for the year include a new fire station in Biltmore Square Mall area, new aerial fire ladder, replacement of vehicles within public works and the police departments and a replacement of the City's mobile radios. (See *Note 4* for additional information)

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**Capital Assets of the City of Asheville**

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Land	\$ 20,620,738	\$ 27,321,138	\$ 9,158,238	\$ 10,271,758	\$ 29,778,976	\$ 37,592,896
Buildings & Improvements	39,181,060	45,098,905	79,450,212	80,560,800	118,631,272	125,659,705
Machinery & Equipment	26,736,590	28,420,969	12,386,069	14,432,930	39,122,659	42,853,899
Infrastructure	216,220,372	204,736,311	91,642,758	109,208,525	307,863,130	313,944,836
Construction In Process	6,508,303	12,266,712	4,183,876	4,559,708	10,692,179	16,826,420
Accumulated Depreciation	(116,676,318)	(120,954,280)	(62,314,856)	(75,332,282)	(178,991,174)	(196,286,562)
Total	<u>\$ 192,590,745</u>	<u>\$ 196,889,755</u>	<u>\$ 134,506,297</u>	<u>\$143,701,439</u>	<u>\$ 327,097,042</u>	<u>\$ 340,591,194</u>

**Long-term Debt.** The City of Asheville's total general obligation and revenue bonds debt decreased by \$4,085,000 (7.0%) during the current fiscal year in accordance with its regularly scheduled maturity dates. The City did not issue any new general obligation bonds. It did, however, advance refund \$42,960,000 in Water Revenue bonds, Series 1996 and 2005 by placing the proceeds of new bonds (Series 2005) in an irrevocable trust to provide for all future debt service payments on the old bonds.

The City of Asheville maintains an "AA" rating from Standard & Poor's and an "Aa2" rating from Moody's for general obligation debt. This bond rating is a clear indication of the sound financial condition of the City.

State statutes limit the amount of general obligation debt a governmental entity may issue to 8% of its total assessed value of taxable property located within that government's boundaries. The legal debt margin for the City of Asheville is \$536,837,778, which is significantly in excess of the City's outstanding general obligation debt. Additional information regarding the City of Asheville's long-term debt can be found in Note 7 of this report.

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**Outstanding Debt---General Obligation and Revenue Bonds**

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
General Obligation Bonds	\$ 7,675,887	\$ 6,057,187	\$ 7,719,113	\$ 6,412,813	\$ 15,395,000	\$ 12,470,000
Revenue Bonds	-	-	42,960,000	41,800,000	42,960,000	41,800,000
Total	<u>\$ 7,675,887</u>	<u>\$ 6,057,187</u>	<u>\$ 50,679,113</u>	<u>\$ 48,212,813</u>	<u>\$ 58,355,000</u>	<u>\$ 54,270,000</u>

**General Fund Budgetary Highlights**

- The unemployment rate for Buncombe County is currently 3.5%, down from a rate of 4.5% one year ago. This compares favorably to the state's average unemployment rate of 4.8%.
- Population of 73,239 has grown 6.3% from 2000 to 2005.
- Inflationary trends in the region compare favorably to national indices.

All of these factors were considered in preparing the City of Asheville's budget for the 2007 fiscal year.

During the current fiscal year, unreserved fund balance in the general fund increased to \$17,297,352. The City of Asheville has appropriated \$445,282 of this amount to balance the FY 2006-07 budget.

**Budget Highlights for the Fiscal Year Ending June 30, 2007.**

The City's adopted General Fund budget for FY 2007 totaled \$77,783,556, which represents a 2.8% increase over the FY 2006 budget. The FY 2007 budget includes \$450,000 to fund the first year implementation of the market-based compensation plan, which will address job classes in police, fire and engineering as well as some of the lowest paid classes in other departments that are drastically below market. Police and Fire expenditures continue to be the largest component of the City's General Fund budget comprising approximately 40% of the total FY 2007 General Fund budget. The FY 2007 budget includes \$448,000 in funding that will allow the Fire Department to hire 18 new firefighters in January 2007. The General Fund budget also includes \$2.1 million in pay-as-you-go capital improvement funding. This funding will allow the City to continue replacing its aging fleet of vehicles and undertake several other high priority projects, including renovations at the Reid Center, construction of the Reed Creek Greenway, and the replacement of the fire station alerting system. The fiscal year 2007 General Fund budget includes \$6.27 in debt service for the City's general obligation bonds, certificates of participation (COPs), and other general debt obligations. Debt service for FY 2007 increased compared to the prior year primarily due to the issuance of \$5.78 million in installment debt to fund the construction of two new fire stations.

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**Business-type Activities.** The FY 2007 budget for the Water Resources Fund includes \$6.1 million from a new capital maintenance fee. The purpose of this fee is to provide funding for major capital improvements such as water line replacements and water treatment source improvements. With this new fee, the total capital budget for FY 2007 is \$10.3 million. This total includes funding for mandatory capital improvement projects, an aggressive meter change-out program, rolling stock, and small capital equipment. Aside from the capital improvement fee, the Water budget maintains current rates, and it is assumed that there will be no growth in demand. Operating expenses will be reduced or held constant wherever possible. Water Resources' debt service for FY 2007, which is 18% of the total budget, includes debt service for the 1992 General Obligation Bonds, the 1996 NC Water Quality Loan, Series 1996 Revenue Bonds, and Series 2001 Revenue Bonds.

During fiscal 2005, there was a \$2,880,858 increase in appropriations between the original and final amended budget of expenditures. Some of the components of that increase were:

- \$77,500 appropriated from fund balance to various departments for FSLA mandated overtime expenses;
- \$63,548 appropriated to the Parks & Recreation department to fund operations at the Aston Park tennis facility, which reverted to the City from Buncombe County;
- \$425,000 appropriated from fund balance for the purchase of equipment for URTV;
- \$765,000 in stop-loss insurance recovery revenue appropriated to cover health care expenditures;
- \$599,610 in reimbursement revenue from FEMA appropriated for expenses incurred during the flood events of September 2004;
- \$85,000 appropriated from fund balance to the Parks & Recreation department for the purchase of various pieces of equipment.

Ad valorem taxes exceeded budget expectations with the assessed valuation of real property increasing by 3.5%. Local option sales tax revenue increased by 7.1% in fiscal year 2005 and exceeded budget by \$485,835. Investment earnings exceeded budgetary expectations due to the increase in interest rates, a shorter reimbursement philosophy and more available cash for investments. The other major General Fund revenue categories – intergovernmental and charges for services – also exceeded budget estimates.

**Requests for information**

This financial report is designed to provide a general overview of the City of Asheville's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Chief Financial Officer, City of Asheville, PO Box 7148, Asheville NC 28802.